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No. 95-781

IN THE

# Supreme Court of the United States

October Term, 1995

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, ETC.,

*Petitioner,*

*vs.*

FEDERAL DEPOSIT INSURANCE CORPORATION, ETC.,

*Respondent.*

**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT**

## PETITIONER'S REPLY BRIEF

John A. Lee
*Counsel of Record for Petitioner*
Andrews & Kurth L.L.P.
4200 Texas Commerce Tower
Houston, Texas 77002
(713) 220-4200

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## PETITIONER'S REPLY BRIEF

May an agency ignore the unambiguous language of its own regulation if enforcing the regulation is economically detrimental to the agency? Petitioner submits it may not.

## I. ARGUMENT

### A. The Regulation Was Unambiguous.

Security Pacific,[1] Petitioner, is trustee under an indenture pursuant to which Santa Barbara Savings issued debentures. Santa Barbara Savings failed in April of 1990 and the RTC was appointed as its receiver. Shortly thereafter, the RTC repudiated the indenture and the debentures issued thereunder, after finding that the indenture and debentures were "burdensome" and that their repudiation would "promote the orderly administration of the affairs of [Santa Barbara Savings]" (Pet. A-54). Security Pacific filed its claim against the RTC, asserting a claim for repudiation which had the Tier 6 priority assigned by the applicable repudiation regulation, subparagraph (c) of 12 C.F.R. § 389.11.

At the time of the repudiation and at the time the claim was made, subsection (c) of 12 C.F.R. § 389.11 (1990) (quoted in full at Pet. A-50) governed the priority of claims against a failed thrift arising from repudiated contracts. After Petitioner's claim was made, the RTC amended the regulation to delete subsection (c), and then assigned the claim to a lower, Tier 9 payment priority than provided by subsection (c).[2]

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[1] Defined terms used in this Reply have the meanings set forth in the Petition. Citations in this Reply to the Petition and its Appendix appear as "Pet.___" and "Pet. A- __" respectively. Citations to Respondent's Brief appear as "Res. Br. __".

[2] The RTC not only ignored the regulation in effect when Petitioner's substantive rights accrued. It effectively repealed the regulation

Subsection (c) of § 389.11 provided that if the receiver of a failed thrift repudiated an executory contract, the resultant claim for damages "shall be classified as a claim that has accrued and become unconditionally fixed on or before the date of default."

Under the payment priority scheme enumerated in subsection (a) of § 389.11, "claims which have accrued and become unconditionally fixed on or before the date of default, whether liquidated or unliquidated" are assigned Tier 6 priority. 12 C.F.R. § 389.11(a)(6). The *exact* same words were used in subsection (c) of § 389.11 and in subsection (a)(6). Because the words are identical this was not a drafting coincidence. There was no reasonable interpretation of subsection (c) that would assign Petitioner's claim to any level other than Tier 6.

### B. Respondent's Arguments Regarding the Interpretation of Subsection (c) Are Not Plausible.

With *no* administrative history to support its argument, Respondent urges that the sole purpose of subsection (c) of § 389.11 must have been to ensure that claims arising from repudiated contracts would not be treated as first priority administrative expenses of the receivership. (Res. Br. pp.8-9). This argument is not plausible because subsection (c) does not

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*ex post facto*. Respondent now argues in this Court the "possibility" that the repealed regulation is not the one that should govern this case. (Res. Br. p. 8, n.3). Respondent cites no authority for this "possibility", a "possibility" which does not exist as shown by the argument and authorities presented by the Petitioner on this point (Pet. p.17, n.5).

merely state the priority that such claims will *not* be assigned. It goes on to state the priority that *is to be* assigned to claims on repudiated contracts. Respondent's argument violates one of this Court's most fundamental rules of statutory construction, by rendering half of subsection (c) meaningless. (Pet. 17-18).

Respondent argued (Res. Br. 9-11) and the Ninth Circuit held (Pet. A-9) that Petitioner's reading of the regulation renders the provisions of § 389.11(a)(7) (contingent claims and interest) and (a)(8) (federal taxes) meaningless in the context of repudiation. However, those types of claims do not arise from executory contracts, and thus do not result from contracts that are subject to repudiation. In fact, Petitioner's interpretation of subsection (c) is not only consistent with the terms of subsection (a), it is the *only* interpretation that does not render part of subsection (c) meaningless.

### C. The Ninth Circuit Ignored an Unambiguous Regulation and Instead Wrongfully Imposed its Own View of Regulatory Intent.

The Ninth Circuit assigned Security Pacific's claim to Tier 9, and simply ignored the effect of the RTC's repudiation. It did so not by applying the language of the regulation, but rather, by imposing what it thought made "sense" and was "rational" (Pet. A-11) in light of its own views as to the purpose of the regulation.

In doing so, the Ninth Circuit did not just adopt "a different interpretation of that regulation from the one petitioner would prefer" (Res. Br., p.12). It adopted an

interpretation that cannot be gleaned from the words of the regulation itself. Respondent's assertion that the Ninth Circuit "did not err by taking the regulation's purpose into account in deciding how its language should be construed" (Res. Br., p.12) ignores the fact that this case does not concern a matter of statutory construction. It concerns the plain language of an unambiguous regulation.

### D. The Ninth Circuit's Actions Were Contrary to Law of this Court.

Respondent argues that since subsection (c) of § 389.11 has been repealed and there is no dispute among the Circuits with respect to § 389.11(c) (Res. Br., p.9), the Ninth Circuit's actions do not warrant Supreme Court review. However, the significance of this case is not any particular interpretation of § 389.11. Rather, it is that a government agency should not be allowed to ignore its own regulations simply because the result of enforcement would be detrimental to the agency. *United States ex rel. Accardi v. Shaughnessy*, 347 U.S. 260 (1954); *Service v. Dulles*, 354 U.S. 363 (1957) and *Vitarelli v. Seaton*, 359 U.S. 535 (1959). Furthermore, the "policy" consideration that compelled the Ninth Circuit to allow the RTC to ignore its own regulation was expressly rejected by this Court in *O'Melveny & Myers v. FDIC*, ___ U.S. ___, 114 S. Ct. 2048, 2055 (1994), which held "there is no federal policy that the [deposit insurance] fund should always win."

### E. The Ninth Circuit Upset Settled Analogous Principles of Bankruptcy Law, and Created a Conflict with the Second Circuit's Holding Regarding the Effect of Repudiation.

Petitioner demonstrated (Pet., pp.11-12 and 15-16) that even ignoring § 389.11(c), the decision of the Ninth Circuit conflicts with settled principles of analogous bankruptcy law governing the rejection of executory contracts. *See NLRB v. Bildisco*, 465 U.S. 513, 531-32 (1984) (Chapter 11 debtor-in-possession must assume executory contract, *cum onere*); *In re Italian Cook Oil Corp.*, 190 F.2d 994, 997 (3d Cir. 1951) (trustee may not blow "hot and cold"; he must either reject or assume the contract in full); and *In re Audra-John Corp.*, 140 B.R. 752, 757 (Bankr. D. Minn. 1992) ("An executory contract is rejected *in its entirety*") (court's emphasis).

The Ninth Circuit's decision also conflicts with the Second Circuit's decision in *RTC v. Diamond*, 45 F.3d 665 (2d Cir.), *cert. denied*, 115 S. Ct. 2609 (1995), which held:

> Congress could not have intended that the RTC would have the power only to disaffirm or repudiate a piece of paper, or certain sections of that document. Rather, Congress must have intended that the repudiation reach the relationships and interests that the document creates.

45 F.3d at 673. Since the agreement to subordinate was set forth in § 4.01 of the indenture, when the RTC repudiated the indenture it necessarily repudiated any subordination relationship that the indenture had created. The Second Circuit held in *Diamond* that repudiation reaches all of the

"relationships and interests that the document creates." *Diamond*, 45 F.3d at 673. The Ninth Circuit does "not see why that should be so in this context." (Pet. A-10).

Respondent argues that the language of § 4.02 of the indenture (which provides that subordination will "in no way be affected, modified, waived or revoked by the occurrence of any Event of Default") overrides the effect of repudiation. That argument ignores two important facts. First, "repudiation" was not an "Event of Default" under the indenture. Second, repudiation of the contract necessarily repudiated *all* of the provisions of the contract, including § 4.02.

### F. The RTC Must Bear the Adverse Consequences of Repudiation.

The RTC could have allowed the claim on the indenture, treated the claim at Tier 9, and paid the claim through receivership certificates redeemable if and as funds became available for Tier 9. It did not. It voided the terms of the contract and left Security Pacific with a simple claim under California law for money lent. *Pleasant v. Samuels*, 114 C. 34, 45 P. 998 (1896).

The RTC chose to repudiate the indenture and debentures because it found that they were "burdensome". In fact, by repudiation the RTC did relieve itself of a number of responsibilities it would have had to perform if the indenture and debentures were not repudiated (Pet., p.16, n.4). The RTC should be required to bear the consequences of its action. As the Ninth Circuit aptly stated in a case where a trustee had

assumed rather than repudiated an executory contract, to the trustee's subsequently discovered disadvantage:

> When a trustee proves wrong in his gamble that the benefits of an assumed executory contract will outweigh the burdens, the Code requires that unsecured creditors, not the contracting party, bear the risk of loss.

*In re Frontier Properties, Inc.*, 979 F.2d 1358, 1367 (9th Cir. 1992).

Rather than simply admitting that the RTC may have made a mistake of judgment when it repudiated the indenture, the Respondent requests that this Court simply ignore what occurred and let stand a Ninth Circuit decision that upsets the settled legal principle that repudiation rejects all of the terms of a contract, including those that may be favorable to the repudiating party, and permits an agency to ignore its own unambiguous regulation in the name of regulatory "purpose". This Court should refuse to do so.

## II. CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

John A. Lee
*Counsel of Record for Petitioner*
Robin Russell
Kay Fenwick
Walter L. Stratton
Andrews & Kurth L.L.P.
4200 Texas Commerce Tower
Houston, Texas 77002
(713) 220-4200